



8011-01P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-84639; File No. SR-NYSEArca-2018-60]

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to List and Trade Shares of the First Trust Long Duration Opportunities ETF under NYSE Arca Rule 8.600-E

November 21, 2018

I. Introduction

On August 17, 2018, NYSE Arca, Inc. (“Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares (“Shares”) of the First Trust Long Duration Opportunities ETF (“Fund”) pursuant to NYSE Arca Rule 8.600-E. The proposed rule change was published for comment in the Federal Register on August 30, 2018.³ On October 9, 2018, pursuant to Section 19(b)(2) of the Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ The Commission has received no comment letters on the proposed rule change. The Commission is publishing this order to institute proceedings pursuant to Section 19(b)(2)(B) of the Act⁶ to determine whether to approve or disapprove the proposed rule change.

¹ 15 U.S.C.78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 83936 (August 24, 2018), 83 FR 44312 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 84383, 83 FR 52039 (Oct. 15, 2018). The Commission designated November 28, 2018 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change. See id.

⁶ 15 U.S.C. 78s(b)(2)(B).

II. Summary of the Exchange's Description of the Proposed Rule Change⁷

The Exchange proposes to list and trade Shares of the Fund under NYSE Arca Rule 8.600-E, which governs the listing and trading of Managed Fund Shares on the Exchange. The Shares will be offered by First Trust Exchange-Traded Fund IV ("Trust"), which the Exchange states is registered with the Commission as an open-end management investment company.⁸ The Fund is a series of the Trust. According to the Exchange, First Trust Advisors L.P. will be the investment adviser ("Adviser") to the Fund,⁹ First Trust Portfolios L.P. will be the distributor ("Distributor") for the Fund's Shares, and The Bank of New York Mellon will act as the administrator, custodian, and transfer agent ("Custodian" or "Transfer Agent") for the Fund.

⁷ For a complete description of the Exchange's proposal, see Notice, supra note 3.

⁸ According to the Exchange, on June 12, 2018, the Trust filed with the Commission its registration statement on Form N-1A under the Securities Act of 1933 (15 U.S.C. 77a), and under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("1940 Act") relating to the Fund (File Nos. 333-174332 and 811-22559) ("Registration Statement"). In addition, the Exchange states that the Commission has issued an order upon which the Trust may rely, granting certain exemptive relief under the 1940 Act. See Investment Company Act Release No. 30029 (April 10, 2012) (File No. 812-13795).

⁹ According to the Exchange, the Adviser is not registered as a broker-dealer but is affiliated with First Trust Portfolios L.P., a broker-dealer, and has implemented and will maintain a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition and/or changes to the portfolio. The Exchange represents that, in the event (a) the Adviser becomes registered as a broker-dealer or newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser is a registered broker-dealer or becomes affiliated with a broker-dealer, it will implement and maintain a fire wall with respect to its relevant personnel or its broker-dealer affiliate regarding access to information concerning the composition of and/or changes to the portfolio, and will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding such portfolio. The Exchange also represents that the Adviser and its related personnel are subject to the provisions of Rule 204A-1 under the Investment Advisers Act of 1940 relating to codes of ethics.

A. Principal Investments of the Fund

According to the Exchange, the investment objective of the Fund is to generate current income with a focus on preservation of capital. Under normal market conditions,¹⁰ the Fund will invest at least 80% of its net assets in a portfolio of “Fixed Income Securities” (described below), which may be represented by derivatives relating to such securities. The term Fixed Income Securities means:

- Debt securities issued or guaranteed by the U.S. Government, its agencies or government-sponsored entities (“GSE” or “U.S. Government Entities”), other than “Agency Mortgage-Related Investments” as defined below;¹¹
- mortgage-related debt securities and other mortgage-related instruments issued or guaranteed by the U.S. Government and U.S. Government Entities (collectively, “Agency Mortgage-Related Investments”); and
- debentures related to securities issued or guaranteed by the U.S. Government and U.S. Government Entities.

The Fund may invest in the following derivative instruments: options, futures contracts, and swap agreements. According to the Exchange, the use of these derivative transactions may

¹⁰ The term “normal market conditions” is defined in NYSE Arca Rule 8.600-E(c)(5). On a temporary basis, including for defensive purposes, during the initial invest-up period (*i.e.*, the six-week period following the commencement of trading of Shares on the Exchange) and during periods of high cash inflows or outflows (*i.e.*, rolling periods of seven calendar days during which inflows or outflows of cash, in the aggregate, exceed 10% of the Fund's net assets as of the opening of business on the first day of such periods), the Fund may depart from its principal investment strategies; for example, it may hold a higher than normal proportion of its assets in cash. The Fund may adopt a defensive strategy when the Adviser believes securities in which the Fund normally invests have elevated risks due to political or economic factors and in other extraordinary circumstances.

¹¹ GSEs include, for example, the Government National Mortgage Association, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation.

allow the Fund to obtain net long or short exposures to selected interest rates or durations. The Fund may also utilize derivatives to enhance return, to hedge some of the risks of its investments in securities, as a substitute for a position in the underlying asset, to reduce transaction costs, to maintain full market exposure (which means to adjust the characteristics of its investments to more closely approximate those of the markets in which it invests), to manage cash flows, or to preserve capital.

The Fund may invest in exchange-traded funds (“ETFs”) that invest in Fixed Income Securities.¹² Such ETFs will count towards the Fund's 80% investment requirement described above.

The Fund may enter into mortgage dollar rolls and may invest in to-be-announced transactions (“TBA”). Cash earmarked or otherwise held as collateral for settling mortgage dollar rolls, TBA transactions, and other delayed-delivery transactions will count towards the Fund’s 80% investment requirement described above. The Fund may enter into short sales of any securities in which the Fund may invest.

B. Other Investments of the Fund

While, under normal market conditions, the Fund will invest at least 80% of the Fund’s net assets in the securities and financial instruments described above under “Principal Investments of the Fund,” the Fund may invest up to 20% of its net assets in the securities and financial instruments described below.

¹² For purposes of this filing, the term “ETFs” includes Investment Company Units (as described in NYSE Arca Rule 5.2-E(j)(3)); Portfolio Depositary Receipts (as described in NYSE Arca Rule 8.100-E); and Managed Fund Shares (as described in NYSE Arca Rule 8.600-E). All ETFs will be listed and traded in the U.S. on a national securities exchange. While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged (e.g., 2X, -2X, 3X or -3X) ETFs.

The Fund may invest in cash and cash equivalents.¹³ In addition, the Fund may hold the following short-term instruments with maturities of three months or more: certificates of deposit, bankers' acceptances, repurchase agreements and reverse repurchase agreements, bank time deposits, and commercial paper.

The Fund may invest up to 20% of its net assets in other fixed income securities, including asset-backed securities ("ABS") and mortgage-related debt securities and other mortgage-related instruments not issued or guaranteed by the U.S. Government or U.S. Government Entities ("Non-Agency Mortgage-Related Investments").¹⁴

The Fund may invest in non-exchange-traded investment company securities (i.e., mutual funds).

C. Other Restrictions of the Fund

The Exchange represents that the Fund will not invest in securities or other financial instruments that have not been described in the proposed rule change.

In addition, the Exchange represents that the Fund's investments, including derivatives, will be consistent with the Fund's investment objective and will not be used to enhance leverage (although certain derivatives and other investments may result in leverage). That is, the Fund's investments will not be used to seek performance that is the multiple or inverse multiple (e.g.,

¹³ For purposes of this filing, cash equivalents are the short-term instruments enumerated in Commentary .01(c) to Rule 8.600-E.

¹⁴ For purposes of this filing, Agency Mortgage-Related Investments and Non-Agency Mortgage-Related Investments consist of: (1) residential mortgage-backed securities ("RMBS"); (2) commercial mortgage-backed securities ("CMBS"); (3) stripped mortgage-backed securities ("SMBS"), which are mortgage-backed securities where mortgage payments are divided up between paying the loan's principal and paying the loan's interest; and (4) collateralized mortgage obligations ("CMOs") and real estate mortgage investment conduits ("REMICs") where they are divided into multiple classes with each class being entitled to a different share of the principal and/or interest payments received from the pool of underlying assets.

2X or -3X) of the Fund's primary broad-based securities benchmark index (as defined in Form N-1A).¹⁵

D. Use of Derivatives by the Fund

Investments in derivative instruments will be made in accordance with the Fund's investment objective and policies. To limit the potential risk associated with such transactions, the Fund will enter into offsetting transactions or segregate or "earmark" assets determined to be liquid by the Adviser in accordance with procedures established by the Trust's Board of Trustees (the "Board"). In addition, the Fund will include appropriate risk disclosure in its offering documents, including leveraging risk. Leveraging risk is the risk that certain transactions of the Fund, including the Fund's use of derivatives, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged.

The Adviser believes there will be minimal, if any, impact to the arbitrage mechanism as a result of the Fund's use of derivatives. The Adviser understands that market makers and participants should be able to value derivatives as long as the positions are disclosed with relevant information. The Adviser believes that the price at which Shares of the Fund trade will continue to be disciplined by arbitrage opportunities created by the ability to purchase or redeem Shares of the Fund at their net asset value ("NAV"), which should ensure that Shares of the Fund will not trade at a material discount or premium in relation to their NAV. The Adviser does not believe there will be any significant impacts to the settlement or operational aspects of the Fund's arbitrage mechanism due to the use of derivatives.

¹⁵ The Fund's broad-based securities benchmark index will be identified in a future amendment to the Registration Statement following the Fund's first full calendar year of performance.

E. Application of Generic Listing Requirements

The Exchange represents that the portfolio for the Fund will not meet all of the “generic” listing requirements of Commentary .01 to NYSE Arca Rule 8.600-E applicable to the listing of Managed Fund Shares. The Exchange states that the Fund’s portfolio will meet all such requirements except for those set forth in Commentary .01(a)(1),¹⁶ (b)(1),¹⁷ and (b)(5),¹⁸ as described below.

1. Fixed Income Securities

¹⁶ Commentary .01(a)(1) to NYSE Arca Rule 8.600-E provides that the component stocks of the equity portion of a portfolio that are U.S. Component Stocks (as described in NYSE Arca Rule 5.2-E(j)(3)); shall meet the following criteria initially and on a continuing basis: (A) subject to exclusions for Derivative Securities Products and Index-Linked Securities, component stocks that in the aggregate account for at least 90% of the equity weight of the portfolio each shall have a minimum market value of at least \$75 million; (B) subject to exclusions for Derivative Securities Products and Index-Linked Securities, component stocks that in the aggregate account for at least 70% of the equity weight of the portfolio each shall have a minimum monthly trading volume of 250,000 shares, or minimum notional volume traded per month of \$25,000,000, averaged over the last six months; (C) subject to exclusions for Derivative Securities Products and Index-Linked Securities, the most heavily weighted component stock shall not exceed 30% of the equity weight of the portfolio, and, to the extent applicable, the five most heavily weighted component stocks shall not exceed 65% of the equity weight of the portfolio; (D) subject to exceptions for where Derivative Securities Products and Index-Linked Securities constitute portfolio components, where the equity portion of the portfolio does not include Non-U.S. Component Stocks (as described in Rule 5.2-E(j)(3)), the equity portion of the portfolio shall include a minimum of 13 component stocks; and (E) equity securities in the portfolio shall be U.S. Component Stocks listed on a national securities exchange and shall be NMS Stocks as defined in Rule 600 of Regulation NMS under the Act; except that no more than 10% of the equity weight of a portfolio may consist of American Depositary Receipts.

¹⁷ Commentary .01(b)(1) to Rule 8.600-E provides that components that in the aggregate account for at least 75% of the fixed income weight of the portfolio each shall have a minimum original principal amount outstanding of \$100 million or more.

¹⁸ Commentary .01(b)(5) to NYSE Arca Rule 8.600-E provides that non-agency, non-GSE and privately-issued mortgage-related and other asset-backed securities components of a portfolio shall not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the portfolio.

The Exchange represents that the Fund will not comply with the requirement in Commentary .01(b)(1) to Rule 8.600-E that components that in the aggregate account for at least 75% of the fixed income weight of the portfolio each shall have a minimum original principal amount outstanding of \$100 million or more.¹⁹ As discussed above, under normal market conditions, the Fund's principal investments will include Agency Mortgage-Related Investments, securities issued or guaranteed by the U.S. Government and U.S. Government Entities other than Agency Mortgage-Related Investments, and debentures related to securities issued or guaranteed by the U.S. Government and U.S. Government Entities. The Exchange states that the Adviser represents that the Agency Mortgage-Related Investments market is extremely large and liquid;²⁰ however, individual bond sizes in Agency Mortgage-Related Investments tend to be slightly smaller on average than standard corporate obligation deal issuances. As an example, the Exchange states that as of March 31, 2018, there were approximately \$3.06 trillion in Fannie Mae outstanding; however, that amount is comprised of tens of thousands of individual pools with a range of individual pool specific issue sizes. The Exchange states that while an individual tranche may be less than \$100 million, it may have been issued as part of a deal in excess of \$100 million.

As an alternative limitation, the Exchange proposes that, except for periods of high cash inflows or outflows,²¹ components that in the aggregate account for at least 30% of the fixed

¹⁹ See supra note 17.

²⁰ According to the Exchange (citing the Securities Industry and Financial Markets Association), the approximate average daily trading volume in agency mortgage-backed securities from 2003-2017 was \$249 billion; the average daily trading volume in agency mortgage-backed securities for June 2018 was approximately \$223.2 billion; and approximately \$6.99 trillion in agency mortgage-backed securities was outstanding as of March 31, 2018.

²¹ See supra note 10.

income weight of the portfolio would have a minimum original principal amount outstanding of \$50 million or more. The Exchange states that the Adviser represents that this alternative criterion is appropriate based on the size and liquidity of the market in which agency mortgage securities generally trade and the anticipated availability of Agency Mortgage-Related Investments that would satisfy the Fund's investment parameters.

The Exchange also represents that the Fund will not comply with the requirement in Commentary .01(b)(5) that investments in non-agency, non-GSE and privately issued mortgage-related and other asset-backed securities (i.e., Non-Agency Mortgage-Related Investments) not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the portfolio.²² Instead, the Exchange proposes that Non-Agency Mortgage-Related Investments will, in the aggregate, not exceed more than 20% of the total assets of the Fund. According to the Exchange, this alternative requirement is appropriate because the Fund's investment in Non-Agency Mortgage-Related Investments is expected to provide the Fund with benefits associated with increased diversification, as Non-Agency Mortgage-Related Investments tend to be less correlated to interest rates than many other fixed income securities. The Exchange states that the Adviser represents that the Fund's investment in Non-Agency Mortgage-Related Investments will be subject to the Fund's liquidity procedures as adopted by the Board, and the Adviser does not expect that investments in Non-Agency Mortgage-Related Investments of up to 20% of the total assets of the Fund will have any material impact on the liquidity of the Fund's investments.

2. Investments in Non-Exchange-Traded Open-End Investment Company Securities

²² See supra note 18.

The Exchange states that the Fund would not meet the requirements of Commentary .01(a)(1)(A) through (E) to Rule 8.600-E²³ with respect to the Fund's investments in non-exchange-traded open-end investment company securities. The Exchange represents that investments in non-exchange-traded open-end investment company securities will not be principal investments of the Fund.²⁴ According to the Exchange, such investments, which may include mutual funds that invest, for example, principally in fixed income securities, would be utilized to help the Fund meet its investment objective and to equitize cash in the short term. In addition, the Exchange states that because non-exchange-traded open-end investment company securities have a net asset value based on the value of securities and financial assets the investment company holds, the Exchange believes it is unnecessary and inappropriate to apply to such securities the criteria in Commentary .01(a)(1). The Exchange further states that it believes it would be difficult or impossible to apply to such securities the generic quantitative criteria in Commentary .01(a)(1) because such securities do not trade in the secondary market.

The Exchange notes that, other than Commentary .01(a)(1), (b)(1), and (b)(5) to Rule 8.600-E, as described above, the Fund's portfolio will meet all other requirements of Rule 8.600-E.

III. Proceedings to Determine Whether to Approve or Disapprove SR-NYSEArca-2018-60 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²⁵ to determine whether the proposed rule change should be approved or disapproved. Institution of

²³ See supra note 16.

²⁴ The Exchange states that for purposes of the filing, non-exchange-traded securities of other registered investment companies do not include money market funds which are cash equivalents under Commentary .01(c) to Rule 8.600-E and for which there is no limitation in the percentage of the portfolio invested in such securities.

²⁵ 15 U.S.C. 78s(b)(2)(B).

such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,²⁶ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, ...to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest."²⁷

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral

²⁶ Id.

²⁷ 15 U.S.C. 78f(b)(5).

presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.²⁸

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, which are set forth in the Notice,²⁹ in addition to any other comments they may wish to submit about the proposed rule change.

In this regard, the Commission seeks comment on the Exchange's statements that the Fund will not comply with the requirement in Commentary .01(b)(1) to Rule 8.600-E that components that in the aggregate account for at least 75% of the fixed income weight of the portfolio each shall have a minimum original principal amount outstanding of \$100 million or more.³⁰ In addition, the Commission seeks comment on the Exchange's proposed alternative requirement for the Fund that, except for periods of high cash inflows or outflows,³¹ components that in the aggregate account for at least 30% of the fixed income weight of the portfolio each shall have a minimum original principal amount outstanding of \$50 million or more. The Commission specifically seeks comment on whether the Exchange has provided enough

²⁸ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

²⁹ See supra note 3.

³⁰ See supra note 17.

³¹ See supra note 10.

information relating to this proposed alternative for the Commission to determine that trading of the Fund's Shares, which would not be subject to the requirement in Commentary .01(b)(1) but would be subject to this alternative requirement, would be consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEArca-2018-60 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEArca-2018-60. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments

are cautioned that we do not redact or edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2018-60 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³²

Brent J. Fields,
Secretary.

³² 17 CFR 200.30-3(a)(57).

[FR Doc. 2018-25881 Filed: 11/26/2018 8:45 am; Publication Date: 11/27/2018]